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IN THE

Supreme Court of the United States

OCTOBER TERM 1947

No. 2351

W. H. WILSON,

Petitioner,

vs.

Commissioner of Internal Revenue

Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

W. H. Wilson, Petitioner.

J. Alex. Neely, Jr.
Counsel for Petitioner.

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To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

W. H. Wilson, petitioner above named, respectfully prays that a Writ of Certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fourth Circuit entered in the above entitled Cause on May 1, 1947, affirming a decision of the

Tax Court of the United States from which Petitioner had appealed.

Statement Of Matters Involved.

The taxpayer, W. H. Wilson, filed his petition before the Tax Court of the United States alleging error of the Commissioner in taxing to the petitioner the portion of the profits of a partnership, W. H. Wilson Co., which had been returned as the income of petitioner's wife, Clarice T. Wilson, and his daughter, Marjorie Anne Wilson. The years involved are 1940 and 1941. Other issues were involved before the Tax Court, the decision of which were not appealed.

W. H. Wilson Company was a successor in business to W. H Wilson, Inc., a corporation begun with Mrs. Wilson's capital, and of which she held the majority of the stock. The corporation was dissolved June 30, 1935, and Mr. and Mrs. Wilson continued the business as a partnership. July 1, 1937, W. H. Wallace and S. E. Adams, two employees of the business, were each given a 10 per cent interest in the partnership in payment of back salaries due them. Mr. and Mrs. Wilson each retaining a 40 per cent interest in the partnership. On August 13, 1939, which was the seventeenth birthday of Marjorie Anne Wilson, the only child of petitioner and

his wife, petitioner and his wife each gave Marjorie Anne Wilson a 10 per cent interest in the partnership. One year later Mrs. Wilson gave Marjorie another 5 per cent interest in the partnership. The partnership returns distributed the income of the partnership thereafter 10 per cent to Adams, 10 per cent to Wallace, 30 per cent to the petitioner, 25 per cent to Mrs. Wilson, and 25 per cent to Marjorie. The distribution was not questioned by the Commissioner for the period ending in 1938 and in 1939, but for the periods ending in 1940 and for the period ending in 1941 the Commissioner questioned the bona fides of the partnership and proposed by the usual deficiency notice to tax the petitioner with 80 per cent of the partnership profits, refusing to recognize either Mrs. Wilson or Marjorie as partners.

W. H. Wilson duly filed his petition with the Tax Court of the United States and the case was heard by a division, Honorable C. Rogers Arundell, Judge, sitting, at Columbia, S. C., in September, 1945. The Court rendered its memorandum findings of fact and opinion, based on which the tax was calculated and decision entered. W. H. Wilson duly filed his petition for review by the United States Circuit Court of Appeals for the Fourth Circuit.

The Tax Court held Mrs. Wilson to be a bona fide partner and Marjorie Anne Wilson not to be a bona fide partner. The Circuit Court of Appeals affirmed the Tax Court.

During the pendency of this action Marjorie married and is now Mrs. Langdon S. Ligon, Jr., is twenty-seven years old, and has a child of her own.

Opinions Below.

1. The opinion of the Tax Court of the United States is printed in the printed record at page 24, the portion of the opinion pertinent to the question involved from pages 24 through 33. It is reported in **Prentice-Hall,** 1946 Tax Court Memorandum Decisions Service at Paragraph 46, 166.

2. The opinion of the United States Circuit Court of Appeals for the Fourth Circuit is reported at ..... F (2nd) ..... and is printed at the end of this brief.

Jurisdiction.

The judgment of the Circuit Court of Appeals for the Fourth Circuit affirming the Tax Court was entered May 1, 1947. The jurisdiction of this Court is invoked under section 240 (a) of the Judicial Code as amended; (28 U. S. C. A. 347 (a)).

Questions Presented.

1. Under the rules laid down by the cases of Lusthaus vs. Commissioner, 66 S. Ct. 539; 327 U. S. 293; and Commissioner vs. Tower, 66 S. Ct. 532; 327 U. S. 280; is the test of a family partnership, to be recognized for tax purposes, the bona fides of the partnership or the contribution of services or capital originating with the partner?

2. Was Marjorie Anne Wilson a bona fide partner of W. H. Wilson Company, or is she precluded from recognition because her capital did not originate with her?

3. Can a mother who owns an investment in a business give that investment to her daughter when neither of them contribute personal services to the business?

Reasons Relied Upon For The Writ.

1. Construction of the law of the cases of Lusthaus vs. Commissioner, 66 S. Ct. 539, and Commissioner vs. Tower, 66 S. Ct. 532.

As more fully shown in the argument the Courts below instead of making the bona fides the test of one being a partner, made the contribution of services or capital originating with the partner an absolute test of the bona fides, considering no other factors.

2. Conflict of opinions of the Circuit Court

of Appeals of various Circuits.

It appears to us that the case of Durwood vs. Commissioner 159 F (2nd) 402, decided by the United States Circuit Court of Appeals of the Eighth Circuit, is in conflict with the opinion in the present case. This is more fully discussed hereinafter in the argument.

Conclusion.

Wherefore, the petitioner respectfully submits that the writ should issue as herein prayed.

W. H. Wilson, Petitioner.

J. Alex. Neely, Jr.
Counsel for Petitioner.

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BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

As to Construction of the Law of the Cases of Lusthaus vs. Commissioner and Commissioner vs. Tower.

The Commissioner of Internal Revenue proposed a deficiency in income taxes against W. H. Wilson for the calendar years 1940 and 1941 proposing to tax him on the distributive share of the earnings of W. H. Wilson Company, a partnership, for the fiscal years ending in the respective calendar years, shown by the partnership's returns as belonging to the wife and daughter of W. H. Wilson. The returns showed for 1940 30 per cent for W.

H. Wilson, 30 per cent for Mrs. Wilson, 20 per cent for the daughter, 10 per cent for Mr. Wallace and 10 per cent for Mr. Adams, for 1941 the same per centages except Mrs. Wilson's and the daughter's shares were 25 per cent each. Mr. Wilson filed a petition with the Tax Court of the United States which found that Mrs. Wilson had furnished the capital for a corporation which in 1935 was succeeded by the partnership with Mr. and Mrs. Wilson as partners; that in 1938 two employees, Wallace and Adams, came into the partnership with 10 per cent interest each; that as to the daughter, Marjorie Anne Wilson (now Mrs. Langdon S. Ligon, Jr.), "On her 17th birthday, Aug. 13, 1939, her Mother and Father each handed her a signed paper reciting the gift to her of a 10 per cent partnership interest, ******. On the occasion of Marjorie Anne's 18th birthday Mrs. Wilson informed her that she was to have an additional 5 per cent interest in the business." (Record page 28) The Court also found that both Mrs. Wilson and Marjorie drew on the business for personal funds, that profits were distributed and each of them received her share and used it for herself, that Marjorie's share was invested in property that was hers in fee simple not under the parents' control.

The Court then quoting from Commissioner vs. Tower 66 S. Ct. 532 and emphasizing "If she either invests CAPITAL ORIGINATING WITH HER *****" found Mrs. Wilson to qualify as a bona fide partner (record 31) and as to Marjorie said "***** it is clear that she has contributed neither services nor capital originating with her. She therefore fails to meet the requirements mentioned in the Tower and Lusthaus cases. We accordingly hold that for Federal income tax purposes the attempt to make her a partner was ineffectual, and the interest of the respective partners in W. H. Wilson Co. remained as before.. i. e., Petitioner and Mrs. Wilson each having a 40 per cent interest, and Adams and Wallace each having a 10 per cent interest." (record page 33).

In the Lusthaus case the wife was not permitted to draw on the business and the profits she received were immediately turned back to her husband to be credited on a note. In the Tower case a husband made a gift to the wife immediately before the formation of a partnership, and the husband continued to manage and control the business and the entire funds the same as before with apparently no distribution of profits at any time to the wife. In the Tower case the Supreme

Court said "Of course, the question of legal ownership of the capital purportedly contributed by a wife will frequently throw light on the broader question of whether an alleged partnership is real or pretending. But here the Tax Court's findings was supported by a sufficient number of other factors in the transaction, so that we need not decide whether its holding as to the completeness of the gift was correct.

"There can be no question that a wife and a husband may, under certain circumstances, become partners for tax, as for other, purposes. If she either invests capital originating with her or substantially contributes to the control and management of the business, or otherwise performs vital additional services, or does all of these things she may be a partner as contemplated by 26 U. S. C., paragraphs 181, 182. The Tax Court has recognized that under such circumstances the income belongs to the wife. A wife may become a general or a limited partner with her husband. But when she does not share in the management and control of the business, contributes no vital additional service, and where the husband purports in some way to have given her a partnership interest, the Tax Court may properly take these circum-

stances into consideration in determining whether the partnership is real within the meaning of the federal revenue laws.

"It is the command of the taxpayer over the income which is the concern of the tax laws. Harrison vs. Schaffner, 312 U. S. 579 (25 (AFTR 1209), 581, 582. And income earned by one person is taxable as his, if given to another for the donor's satisfaction. Helvering vs. Horst, 311 U. S. 112 (Supra), 119. It is for this reason, among others, that we said in Helvering vs. Clifford, supra, 335, that transactions between husband and wife calculated to reduce family taxes should always be subjected to special scrutiny. For if under circumstances such as those now before us, the end result of the creation of a husband-wife partnership, though valid under state laws, is that income produced by the husband's efforts continues to be used for the same business and family purposes as before the partnership, failure to tax it as the husband's income would frustrate the purpose of 26 U. S. C. paragraph 22 (a). By the simple expedient of drawing up papers, single tax earnings cannot be divided into two tax units and surtaxes cannot be thus avoided.

Judged by the actual result achieved, the

Tax Court was justified in finding that the partnership here brought about no real change in the economic relation of the husband and his wife to the income in question. Before the partnership the husband managed, controlled, and did a good deal of the work involved in running the business, and he had funds at his disposal which he either used in the business or expended for family purposes. The wife did not contribute her services to the business and received money from her husband for her own and family expenses. After the partnership was formed the husband continued to control and manage the business exactly as he had before. The wife again took no part in the management or operation of the business. If it be said that as a limited partner she could not share in the management without becoming a general partner the result is the same. No capital not available for use in the business before was brought into the business as a result of the formation of the partnership. And the wife drew on income which the partnership books attributed to her only for purposes of buying and paying for the type of things she had bought for herself, home and family before the partnership was formed. Consequently the result of the partner-

ship was a mere paper reallocation of income among the family members. The actualities of their relation to the income did not change. There was, thus, more than ample evidence to support the Tax Court's finding that no genuine union for partnership business purposes was ever intended and that the husband earned the income. Whether the evidence would have supported a different finding by the Tax Court is a question not here presented."

All of the reasoning of the Court is directed not to whether the purported partner contributed capital originating with her but to the bona fides of the partnership, and the facts as to the contribution of capital the method of contribution, and the performance of services are evidence to be considered with any other facts in determining the bona fides of the partnership.

In the present case the Tax Court and the Circuit Court of Appeals made it a required test that the partner must either perform personal services or contribute capital originating with her. The Tax Court found the facts as to services, the drawing on the partnership for funds, the receiving, managing and owning of distributed profits to be identical as to Mrs. Wilson and to Marjorie, the

only difference being that Mrs. Wilson contributed capital originating with her and Marjorie's capital was a gift, the capital originating three-fifths from her mother and two-fifths from her father. The Tax Court applied the test of the origination of capital and held Mrs. Wilson to be a bona fide partner and Marjorie not to be. The Tax Court found the gifts to Marjorie to be effective, found her to receive her share of profits and use them as her individual property, to have the right to draw on the partnership for funds and found that she did draw for funds, in other words, that she had the command over that portion of the income of the partnership instead of the petitioner, but nevertheless said "It is clear that she has contributed neither services nor capital originating with her. She therefore fails to meet the requirements mentioned in the Tower and Lusthaus cases." The Court thus held that the requirements of the Tower and Lusthaus cases were to perform services, or to contribute capital originating with her, whereas the requirements of the Tower and Lusthaus cases were that the partnership be bona fide and the contributing of capital and the method of contribution be some of the factors to be considered in considering who

is the actual and beneficial owner of the invested capital at the time the income is earned.

Conflict of Opinions of the Circuit Court of Appeals Of Various Circuits.

In the case of Durwood vs. Commissioner 159 F (2nd) 402, the United States Circuit Court of Appeals for the Eighth Circuit found that the taxpayer who was a member of a partnership with three brothers prior to 1938, with each of them having a 25 per cent interest had taken in his son in 1938 making his percentage for 1938 20 per cent, in 1939 the taxpayer was to have 35 per cent, and in 1941 taxpayer's share was reduced to 21 per cent bringing in the wife of the taxpayer and his daughter. The business was expanding all of the time so that the income of the taxpayer continued as great as it had been before the reduction in his per cent interest in the partnership. In that case the wife and daughter did not render personal services but leases to theaters had been taken in their name. It does not appear from the opinion that any sums of capital were advanced by either of them personally. The Court held that they were bona fide partners and reversed the Tax Court.

The Wilson case is in many respects simi-

lar to the Durwood case. The capital in the Wilson case had originated with the wife which makes it stronger in favor of the taxpayer than the Durwood case. Mrs. Wilson had furnished all the capital which originated the business. Mr. Wilson had contributed services for it as had the other two partners. The business was beginning to expand and Mrs. Wilson, desiring to make her only child independent, gave her part of her investment. Mr. Wilson joined her in it and the per cent of division of profits was reallocated among the partners, but Mr. Wilson received much more for his services after the reallocation than he did before.

The doctrine of the Wilson case as decided by the Fourth Circuit is in conflict with the doctrine of the Durwood case as decided by the Eighth Circuit.

Finally.

The underlying principle of both the Tower and the Lusthaus cases is the bona fides of the partnership, the actual and beneficial ownership of the capital, not the method of obtaining the ownership. Further, in the Tower case the Court said, "It is the command of the taxpayer over the income which is the concern of the tax laws". Marjorie Anne Wilson certainly had command over the income

that was hers and petitioner did not.

We respectfully submit that a writ of certiorari should be issued in this case, and the doctrine of bona fides as to family partnerships be again stated by this Court. For it to be the law that a citizen of this country cannot make a bona fide gift of any income producing property that he desires to a member of his family, or that the tax laws will not recognize a bona fide gift is taking away from the free citizen of a free country a part of his freedom. The construction placed on the law by the lower Courts taxes the petitioner on income which is not his, has never been his, and will never be his.

Respectfully submitted,

J. Alex. Neely, Jr.
Attorney for Petitioner.

Opinion of the United States Circuit Court of Appeals For the Fourth Circuit.

Before Parker, Soper and Dobie,
Circuit Judges.

Per Curiam:

The only question before us on this appeal is the taxability for the years 1940-1941 to the petitioner, W. H. Wilson, of the income from a share of the partnership which the petitioner gave to his daughter. At the time of the gift, the daughter was seventeen years old. It was not contemplated that the daughter would make any contribution either in money or services to the partnership, which was engaged in the business of buying, selling and other services in connection with cotton. And the record discloses that the daughter never made any such contributions. The Tax Court of the United States decided against the petitioner and we must affirm that decision.

Quite apart from the limitations on our Court in reviewing decisions of the Tax Court imposed by Dobson vs. Commissioner, 320 U. S. 489 (31 AFTR 773), we feel that the only question before us is very definitely foreclosed against the petitioner on both reason and authority. No business purpose was served by the petitioner's transfer to the mi-

nor daughter of a portion of his interest in the partnership. The conduct, control and management of the partnership business went on just as it did before the transfer. All that the daughter did was to receive her share of the partnership income.

In Mauldin v. Commissioner, 155 F. 2d 666,668 (paragraph 72,496 P-H 1946 Fed.), our Court said:

"In summary, this case merely represents another of the stream of cases now coming before the Court wherein taxpayers have sought by various types of reallocation of income within the family group to retain the enjoyment of a large income without the normally incident tax consequences. This Court recently passed upon another such device which we found to be equally unavailing. Hash v. Commissioner, 4 Cir., 152 F. 2d 722 (paragraph 72,325 P-H 1946 Fed.). We do not mean that all reallocations of income within a family group are to be set aside for tax purposes. But such arrangements, to be recognized, must have a reality and substance which is not found in the instant case. The decision of the Tax Court of the United States is accordingly affirmed." And in the Mauldin and Hash cases, we were applying the principles clearly set out by the

Supreme Court in Commissioner v. Tower, 327 U. S. 280 (paragraph 72,016 P-H 1946 Fed.); Lusthaus vs. Commissioner, 327 U. S. 293 (paragraph 72,015 P-H 1946 Fed.). See, also, Helvering v. Horst, 311 U. S. 112 (24 AFTR 1058); Helvering vs. Clifford, 309 U. S. 331 (27 AFTR 1077); Dekorse v. Commissioner, 5 TC 94, affirmed per curiam 158 F. 2d 801 (paragraph 72,265); Miller v. Commissioner, 150 F. 2d 823 (paragraph 72,619 P-H 1945 Fed.); Doll v. Commissioner, 149 F. 2d 239 (33 AFTR 1264), cert. den. 326 U. S. 725.

Counsel for petitioner strenuously argued that the instant case can be distinguished from the cases cited above by virtue of the fact that here, in addition to the gift of petitioner, the girl's mother (who was also a partner) gave a portion of her partnership interest to the daughter. This, we think, is a distinction without a difference. Since the Commissioner here is taxing to the petitioner only the income from the petitioner's gift of a share of his interest in the partnership, no good reason exists why this should be affected by the mother's gift to the same daughter.

The decision of the Tax Court of the United States is affirmed.